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Date:

October 23, 2006

X =

A =

B =

C =

Estate =

Trust =

1

Trust =

2

D1 =

D2 =

D3 =

Year 1 =

Dear :

This responds to a letter dated December 21, 2005, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

X made an election to be treated as an S corporation effective D1. Pursuant to the will of A, A's estate transferred shares of X to Trust 1 on D2. B, the beneficiary of Trust 1, died on D3, and the X stock held by Trust 1 was transferred to Trust 2, of which C is the sole income beneficiary. Trust 2 is represented as being eligible to be a qualified subchapter S trust (QSST) under § 1361(d). However, C failed to make a QSST election for Trust 2. X's S corporation election terminated on D3, upon the transfer of the X stock to Trust 2.

X represents that the failure to file the QSST election for Trust 2 was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(iii) provides that, for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder, but only for the 2-year period beginning on the day on which such stock is transferred to it.

Section 1361(d)(1) provides that in the case of a QSST for which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust that consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made. Section 1361(d)(2)(A) provides that a beneficiary of a QSST may elect to have § 1361(d)(1) apply.

Section 1361(d)(3)(B) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" means a trust all of the income (within the meaning of § 643(b)) of which is distributed currently to one individual who is a citizen or resident of the United States.

Section 1361(d)(4) provides that if any QSST ceases to meet any requirement of § 1361(d)(3)(B) but continues to meet the requirements of § 1361(d)(3)(A) (regarding the terms of the trust), the provisions of § 1361(d) shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of § 1361(d)(3)(B).

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing

and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that the termination of X's S corporation on D3 was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, provided X's S corporation election was valid and provided that the election was not otherwise terminated under § 1361(d). Trust 2 will be treated as a QSST from D3 and thereafter. The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Specifically, this ruling is conditioned upon (1) C filing an appropriately completed QSST election for Trust 2 effective D3 and (2) C and Trust 2 filing amended returns for their respective Year 1 taxable years consistent with the treatment of Trust 2 as a QSST and C as the deemed owner of the portion of Trust 2 consisting of X stock. The QSST election and the amended returns must be filed within 60 days following the date of this letter and a copy of this letter should be attached to any such elections or returns.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion on whether Trust 2 is otherwise eligible to be a QSST.

This ruling is directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

J. THOMAS HINES  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes